

## PREFATORY NOTE

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Meeting of the Federal Open Market Committee  
December 17, 1991

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, December 17, 1991, at 9:00 a.m.

PRESENT: Mr. Greenspan, Chairman  
Mr. Corrigan, Vice Chairman  
Mr. Angell  
Mr. Black  
Mr. Forrestal  
Mr. Keehn  
Mr. Kelley  
Mr. LaWare  
Mr. Lindsey  
Mr. Mullins  
Mr. Parry  
Ms. Phillips

Messrs. Hoenig, Melzer, and Syron, Alternate  
Members of the Federal Open Market Committee

Messrs. Boehne, McTeer, and Stern, Presidents of  
the Federal Reserve Banks of Philadelphia,  
Dallas, and Minneapolis, respectively

Mr. Kohn, Secretary and Economist  
Mr. Bernard, Deputy Secretary  
Mr. Coyne, Assistant Secretary  
Mr. Gillum, Assistant Secretary  
Mr. Mattingly, General Counsel  
Mr. Patrikis, Deputy General Counsel  
Mr. Prell, Economist  
Mr. Truman, Economist

Messrs. Beebe, Lindsey, Promisel, Scheld,  
Siegman, Simpson, Slifman, and  
Ms. Tschinkel, Associate Economists

Mr. Sternlight, Manager for Domestic Operations,  
System Open Market Account

Mr. Ettin, Deputy Director, Division of Research  
and Statistics, Board of Governors

Ms. Low, Open Market Secretariat Assistant,  
Division of Monetary Affairs, Board of  
Governors

Mr. Hendricks, First Vice President, Federal Reserve  
Bank of Cleveland

Messrs. J. Davis, T. Davis, Ms. Greene, Messrs. Lang,  
Rolnick, and Rosenblum, Senior Vice Presidents,  
Federal Reserve Banks of Cleveland, Kansas City,  
New York, Philadelphia, Minneapolis, and Dallas,  
respectively

Messrs. Frydl, Goodfriend, and McNeese, Vice Presidents,  
Federal Reserve Banks of New York, Richmond, and  
Boston, respectively

Mr. Belongia, Assistant Vice President, Federal Reserve  
Bank of St. Louis

Ms. Meulendyke, Manager, Open Market Operations, Federal  
Reserve Bank of New York

Transcript of Federal Open Market Committee meeting of  
December 17, 1991

CHAIRMAN GREENSPAN. Before we get started with our agenda, I'd like to welcome our two new Board members to their first FOMC meeting. I trust it will be both interesting and inspiring; I can pretty much guarantee the first.

MR. BLACK. Mr. Chairman, there may be some people who still entertain doubts that Governor Lindsey is actually from the Fifth District, but he is wearing the Thomas Jefferson tie. If you can arrange it, I think it would be good if you would call Terry Sandford and tell him you'd like him to come over and meet him; he would recognize the tie!

CHAIRMAN GREENSPAN. Would somebody like to move the minutes of the previous meeting on November 5th?

SPEAKER(?). So moved.

CHAIRMAN GREENSPAN. Is there a second?

MR. KELLEY. Second.

CHAIRMAN GREENSPAN. Without objection. Gretchen Greene, would you bring us up to date on the Foreign Desk?

MS. GREENE. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Are there questions for Ms. Greene? If not, would somebody like to move the [amendment to the reciprocal currency arrangement with the Netherlands Bank] that was requested?

VICE CHAIRMAN CORRIGAN. I'll move it.

CHAIRMAN GREENSPAN. Is there a second?

MR. KELLEY. Second.

CHAIRMAN GREENSPAN. Without objection. Would you continue?

MS. GREENE. I would like now to report to you on our discussions with the Bundesbank regarding the possibility of altering the double-forward investment facility provided for the investment of the bulk of the U.S. authorities' German mark reserves. [Continuation of statement--see Appendix.]

CHAIRMAN GREENSPAN. Are there any questions for Gretchen? Would somebody like to move [the ratification of the transactions in foreign currencies during the intermeeting period]?

VICE CHAIRMAN CORRIGAN. I'll move it.

CHAIRMAN GREENSPAN. Is there a second?

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. Without objection. Thank you very much. Peter Sternlight on the Domestic Desk.

MR. STERNLIGHT. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Questions for Peter?

MR. BOEHNE. What is the status of the notion that the Treasury would rely less on long-term bonds?

MR. STERNLIGHT. Well, Secretary Brady acknowledged at a couple of recent Congressional hearings that they are looking at the question of the extent of their reliance [on them]. He seemed to be trying to downplay the effects that might follow from that, noting it is only a modest portion of their net borrowings; 7-1/2 percent or so is done in the 30-year area. I believe that, after a very sharp reaction following that first day's reference, a clarification came out [from the Treasury] to the effect that people should not look for them to abandon totally the long bonds. So, the market was left with the impression that there might well be some scaling down but probably not an abandonment.

MR. BOEHNE. Is this a variation of the Operation Twist idea?

MR. STERNLIGHT. Well, it has some resemblance, although in the case of Operation Twist there was a positive desire to see short-term rates higher as a balance-of-payments remedy; that element has not been present this time. The Treasury might just [want to] leave both ends lower.

MR. KOHN. And to our knowledge, they haven't tried to enlist the Fed in this effort--at least not yet.

CHAIRMAN GREENSPAN. Any other questions for Peter?

MR. SYRON. Peter, is there a central tendency in the range of views on the effectiveness of this kind of thing? It seems to have had a big expectations effect.

MR. STERNLIGHT. We hear such a range of views that it would be hard to say whether there's a real coalescing. I have heard very strongly put views from some in the bond market who think it would not do much good at all; and they are very troubled with the idea of tinkering with the Treasury's regularity and reliance on the long end. On the other hand, there are some who feel that some modification could be useful and recommend it as at least a partial step.

CHAIRMAN GREENSPAN. Now, what is interesting here is that there has been extensive literature on Operation Twist, and my recollection is that it's pretty mixed. No one has been able to confirm that there is a significant supply-side effect occurring in that particular context. On the other hand, there is also evidence, mainly in the recent period, that the Treasury rate is higher relative to private instruments than it otherwise would be, from which one assumes that there is a supply-side effect. So, I would say that there is no really strong analytical evidence that confirms this one way or the other. And what I find a little surprising is how strongly

the market responded to Brady's initial [remarks]; I think rates moved down 5 basis points at the long end of the market.

MR. ANGELL. Unfortunately, any time public officials make comments about taking away the supply of an instrument that the markets have been accustomed to using-- . And with the considerable demand for strips that is out there, it does seem to me a bit dangerous to destroy in a sense an entire market system, including that largest commodity of all which is Treasury bond futures. That is, I think moderating the supply is quite different from any discussion of taking the instrument away.

CHAIRMAN GREENSPAN. Any further questions for Peter? If not, would somebody like to move to [ratify] the actions of the Desk since the last meeting?

MR. KELLEY. So move.

SPEAKER(?). Second.

CHAIRMAN GREENSPAN. Without objection. We now move on to reviewing an issue that we have discussed previously. You may recall that Governor Kelley raised a question with respect to the directive language relating to intermeeting instructions. We've gone through a series of [discussions] on that and I thought it might be useful if Governor Kelley could bring us up to date on where we stand and perhaps make recommendations as to how we might finally resolve this question.

MR. KELLEY. Thank you, Mr. Chairman. The Committee will recall that after our inconclusive discussion of this matter on August 20th, the Chairman asked me, with the good help of Norm and Don, to poll the Committee and see if a preference could be developed. We appreciate the response of Committee members. Everyone participated but I have to say that it still was not at all definitive. We had presented three options. The poll came out 7 for option 1, 7 for option 2, and 2 for option 3, which left us in a bit of a quandary. As a result of that, we felt that we should at least come back today and put on the table again the two recommendations that were at either end of the spectrum [of alternatives]. If you'll turn to pages 17 and 18 of your Bluebook, alternatives II and III there represent the two ends of the spectrum of possibilities that we discussed earlier. Alternative II would represent the continuation of the current approach. And if the Committee comes out of this discussion wishing to go that route, we'll have to look further at whether or not we want to change the order of what we have. Alternative III on page 18 is the other end of the spectrum, which is to delete the entire matter and start over. I would like to recommend, if I may, alternative I on page 17. This is the response to the initial alternative number II from the memo back last fall, which is to try to use elements of what we have had but restructured somewhat. You've read that language and I won't repeat it. This is an attempt to focus on long-term goals, which is the essence of the old alternative number II. It also makes reference to the factors that the Committee considers in its directive. That is in reference to the old alternative I, which called for continuing that. Also, by watering this down and making it much more generic, it is an attempt to give, at least on an implied basis, some emphasis to the desire possibly to get away from this

system altogether. So, Mr. Chairman, my recommendation would be that we adopt this language in alternative number I on page 17 of the Bluebook with the understanding, of course, that this could be brought up and reviewed at any time and probably should at any rate be looked at by the Committee at least once a year.

CHAIRMAN GREENSPAN. I think that's pretty reasonable and I would support your point of view on this. I think it's a clear improvement over where we stand.

MR. PARRY. I would support it as well. I think it's good to have the distinction between long-run objectives and attention to the shorter-term developments in the economic, financial, and monetary areas in the same basic sentence. And I think it's an improvement over what we had.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. For the reasons that the Chairman and Bob Parry gave and that Mike Kelley talked about, I support this. It does make it clearer and I like the idea of considering it once a year rather than debating at Committee meetings the exact wording of this from time to time. The only question I have--I'm just curious--is that I'd like to ask Peter how much all the things we put out there are scrutinized. I don't see [this matter] coming up on the screens often. I do see it in newsletters, etc. Given the [directive] publication lags, how big a deal is that? I support doing it but I'm just curious.

MR. STERNLIGHT. I think [the order] gets attention when there are changes.

MR. SYRON. How much attention?

MR. KELLEY. That's why it has not been a big deal.

MR. STERNLIGHT. It gets the analysts' attention and they write about it in their market letters and so on.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, I think Governor Kelley has done us a real service in bringing this question up, and I would strongly support his recommendation seconded by you. I'm particularly pleased that he listed price stability and then sustainable economic growth, since I feel so strongly that that is the route by which we reach sustainable economic growth. So, I really like the order of those.

MR. KELLEY. That was especially for you, Bob!

MR. BLACK. Well, there were some others too--you included, I think.

MR. KELLEY. Sure.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. I support Governor Kelley's position.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. I can support that position. I guess I don't have quite as much enthusiasm as others have expressed. It seems to me that Governor Kelley ought to know how hard it is to change it once we've done this. And with this language it's just almost impossible to change it, so I think we're back in the same circumstance. I do believe there are times that the Committee may wish to give a signal of changing emphasis; it seems to me that during the '80s we had foreign exchange markets that did need some attention. And having a way of responding to that which is necessary, I think, was helpful. At the same time the movement up in the order of "price level stability" was a part of the announcement or the signal of the Committee's determination in that regard, which I think frankly will get lost in this arrangement. But I can understand when something is going [to be approved] and so I'm going to vote for it! [Laughter]

MR. BLACK. It will shorten the meetings; that's another advantage of it. I wish I had thought to mention that!

CHAIRMAN GREENSPAN. President Forrestal.

MR. FORRESTAL. Mr. Chairman, I think this is a clear improvement over what we have, so I would support Governor Kelley's recommendation. I take Governor Angell's point; there's something to be said for that. On the other hand, I don't think we're precluded from making a change if at some point we really wanted to send a signal. So, I look forward to reviewing it again next year.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. I also can read the tape and support this. I do agree with Governor Angell that it's useful to have a mechanism to signal special concern. He mentioned the exchange markets; there might also be a case where the stock market is weak or financial institutions are very weak and we might want to signal that that's a concern. As Bob Forrestal said, we still could do that. I think this is an improvement overall, though, and I would support it.

CHAIRMAN GREENSPAN. Just a word to our two new members: If you seriously believe that what you're hearing here is that people are falling in basically because other people are falling in, the same people will sell you the Brooklyn bridge! Governor LaWare.

MR. LAWARE. I would much prefer alternative III. I think it's simple and straightforward and it gives the opportunity to emphasize in the Policy Record anything that we want to call particular attention to. However, I, too, can see that the train already has left the station, so I will support alternative I as a step in the right direction.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, while I might have a preference for adjusting the wording slightly or the order of the objectives, I think



I hear the way things are going and I support Governor Kelley's recommendation.

CHAIRMAN GREENSPAN. Does anybody else wish to make any comments? We will not have an official vote on this but will embody the obvious consensus in the directive when that is discussed and voted upon later in the meeting. I thank Governor Kelley. And I am impressed with the way he strong-armed everybody on the Committee into accepting his position! We now move to the economic situation and Messrs. Prell and Truman will prevail.

MR. PRELL. [Statement--see Appendix.]

MR. TRUMAN. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Thank you. Questions for either of the gentlemen?

MR. FORRESTAL. Mike, we've talked a lot about consumer confidence over the last couple of months. I'm just curious: How much do you take into account in your forecast the Conference Board surveys and the Michigan Survey results?

MR. PRELL. Well, [the reliability of the] information we are getting from those data is a matter of considerable dispute among researchers. I think there is considerable evidence that they do add something to the relevant data one has for judging what consumer spending is doing currently. The increment to our knowledge of what will happen down the road is probably more limited. We had basically taken it as a sign early on, when we saw the drop in last month's figures, that this was going to be a weak quarter for consumer spending; and I wouldn't want to read much more into it at this point.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. In the key assumptions section, you discussed fiscal policy and indicated that action was likely but that the impact was likely to be quite small in terms of affecting the economy in '92 or '93. I wondered if you could give us some views about what some of the most likely possibilities are. This is more a question for Don Winn, I guess.

MR. PRELL. Well, I would duck that to anyone I could! If we had a strong conviction about what the composition and magnitude of any package would be, given our guess that something is going to happen, we would have put it in. We really don't know. There are significant differences among the packages, [such as] emphasis on actions that would reduce the cost of capital versus other things that would provide a rapid transfer of income to middle class households or whatever. These things vary considerably and their impacts would be significantly different, I think, in timing and potential dimension.

MR. PARRY. It seems to me that a lot of them, in the effort to try to maintain the integrity of the budget agreement, end up almost with no effect.

MR. PRELL. Well, that fact was one of the reasons--and I think we at least hinted at it--why we didn't put it in. I do think

they still feel somewhat constrained at this point by the size of the budget deficit and the Budget Act itself. No one seems to be talking about really large net fiscal impulses, so we felt we wouldn't be missing much by not including the package in the forecast at this point and merely suggesting that the direction is likely to be stimulative but probably not very large.

MR. PARRY. Thank you.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Mike, you [raised] a question on equipment spending. On the face of it there is a pretty significant change, with different concepts to some extent, between equipment spending in this Greenbook and the last Greenbook. There's some discussion of this, but I was curious: Is this almost entirely attributable to changes in weights in the computer sector so that, in terms of how you think businesses are reacting, there is nothing to be read into your forecast on equipment spending this quarter as compared to last quarter?

MR. PRELL. Well, the change in computer deflators that went into the index is a major factor in the change in this forecast.

MR. SYRON. It must be a big change!

MR. PRELL. But we've also anticipated, in light of the stalling out of overall activity, that there's going to be a greater deferral of equipment spending. So there's an element of fundamental change in the forecast. I might also note that the revisions in the national income accounts give a larger weight to nonresidential construction in business fixed investment. And given that that's a very weak component in the forecast, that also tends to damp the expansion of business fixed investment in this forecast.

MR. TRUMAN. One other aspect of this is that on the trade in computers, which is subject to the same kind of influences, it does seem that there has been a structural shift. Our trade in the computer area, broadly defined, is such that essentially we now have balanced trade. We've gone from a situation in which we had a slight surplus in this [area] to balanced trade. That seems to be associated largely with the change in the structure of the market whereby mainframes and so forth are being de-emphasized and peripherals, software, and other computer processing [equipment] are being emphasized more. [These categories] are those that tend to come in from abroad and [they are subject to] all kinds of relocation decisions and so forth and so on. We have vaguely adjusted to that process as it seems to have unfolded over the course of 1991, and we see no basis for [assuming] it will change. Therefore, we have in some sense a stronger import component to computer-related demands than we had built into our forecast before.

CHAIRMAN GREENSPAN. Any other questions? If not, can we start on our round table? Who would like to start off?

MR. MELZER. Alan, I'll start on the theory that if I say something positive maybe we'll get three or four more [doing so] after

me; that's the usual pattern. Lately, we've been starting too much on a negative note, so I'm going to go first.

In terms of the latest numbers we have on the District, we have had reasonably strong payroll employment growth over the period, about a percentage point higher than nationally. Most of that is coming from manufacturing, although there's some growth in the nonmanufacturing segment. Residential construction is particularly strong over the three-month period. Contracts are up 10 percent; that's not at an annual rate; that's a percentage increase over the prior three-month period. Nonresidential is still weak.

Our banking sector really continues to look very good. If we look at the numbers through the third quarter in the Eighth District overall, we're looking at: 1 percent ROAs; 12-1/2 percent ROEs; nonperforming loans that are really up imperceptibly over the last year and are at less than 2 percent; and reserves that are about 10 basis points shy of fully covering nonperforming loans. In fact, in the month of November at the large reporting banks we have seen for the first time some meaningful loan growth, mostly in the C&I sector. That sector in that month was up 2 percent--not an annual rate but 2 percent absolutely.

The anecdotal information is hard to read, but what I keep picking up is that [business conditions] are basically pretty much the same, though I wouldn't be surprised to see a little deterioration in employment showing through in the last couple of months of the year. The national sentiment that we all read about in the press is quite a bit different than the numbers we're seeing in the Eighth District.

As for the economy overall, the only comment I'd be inclined to make is that I think there are dangers inherent in trying to apply what the economy is doing right now to what policy ought to be doing. I worry increasingly about that. Obviously, that doesn't take account of the lags, and there is no gauge of the thrust of policy in there. That's all I have. I hope we get some positive comments to follow.  
[Laughter]

CHAIRMAN GREENSPAN. That wasn't bad; it's like a jump-start. President Forrestal.

MR. FORRESTAL. Well, maybe I should defer my comments!  
[Laughter] I'm not sure I can fulfill Tom's expectations, although I don't think I'll be completely negative. Tom. Basically, Mr. Chairman, there has been very little change over the past couple of months in the level of economic activity in the Sixth District. That is to say, I think we're just bumping along the bottom; there's no acceleration, but there's no perceptible deceleration either. Some of the people I've talked to over the past couple of weeks, including our directors, tend to confirm this. They certainly are not very happy with the state of the economy, but they also are reporting that they don't anticipate any further declines.

Retail sales are better than retailers had expected. One of the things that is constraining sales in the District is low inventories, and that's especially true of discounters. All of the retailers, of course, are citing very cautious spending--a cautious attitude--on the part of consumers. A lot of consumers apparently are

waiting for further markdowns, further promotions. So, as we get closer to Christmas, there's an expectation on the part of some of the retailers that they may get a surge in their sales this week or early next week. We did a survey of retailers in the four states that have most of the population in our District and they're anticipating an increase of 2 to 3-1/2 percent. That was [the figure] for the 23 days ending on December 7; I hope they're able to realize that for the entire season. The gains are generally in nondurables, as I guess we would expect.

Residential real estate activity is basically flat. The commercial side is still very, very poor. The commercial developers are still complaining about lack of credit. But for the most part I think their not getting credit is a good thing because I don't think they are very good credit risks, at least the ones I've talked to. On the other side of the fence, very large firms in the District outside of the commercial real estate area are reporting that bankers are now coming down and visiting them with some regularity, attempting to book some business. Those firms, of course, are the ones that can go anywhere in the marketplace to get financing. So, that's the situation in the District. It's very little changed; it's basically flat for the most part.

With respect to the national economy, our forecast was revised down but not quite as much as the Greenbook forecast. Our forecast for the current quarter and the first quarter is somewhat higher than the Greenbook. As we get out in the second half of 1992, the two forecasts are about the same, but then we show a modest deceleration as we get into 1993. The differences are basically in consumption and investment. Our inflation forecast is lower this quarter and in the first quarter of next year than the Greenbook but higher over the forecast horizon. I certainly agree with the comment in the Greenbook that the risks to the forecast seem to be more evenly balanced than they have been recently.

What all of this suggests to me in terms of policy is that we certainly have done a lot over the past several months. And I think at this point that we have to be very careful not to overdo the stimulus in the economy; we need to proceed very, very cautiously. Thank you, Mr. Chairman.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, business sentiment and confidence and general economic conditions in the Twelfth District have deteriorated since our last meeting. Confidence of District business leaders and expectations of retail sales have weakened. The comments we receive from our directors and Beigebook contacts are now almost uniformly negative with the only exceptions being those from Utah and Idaho, where conditions are really quite good. Department store and auto sales in early December are reported to be extremely weak throughout the District. Employment conditions in California and the State of Washington have worsened while remaining the same in other District states--that is, relatively strong with the exception of Arizona. After leveling this summer, payroll employment in California has fallen for three consecutive months. And employment in the State of Washington has declined in 7 of the past 8 months, with job losses centered in construction and also in trade. Manufacturing employment

in the State of Washington remains stable and that's largely a result of the strength of Boeing. Conditions in most other District states are relatively stronger. In October, employment expanded at annual rates ranging from 1.6 percent in Hawaii to 13 percent in Alaska, with most states growing in the 7 to 9 percent range. Employment in Arizona, however, declined for the second consecutive month.

As I'm sure you know, agriculture has become the largest industry in California and it's very important in the District as well. We seem to have a series of problems that affect agriculture, such as drought and those kinds of things. The new one, of course, is the white fly infestation, which is devastating the Imperial Valley. What we now see is of such a magnitude that it actually had a significant impact on the CPI in November. So, we're not sure what other natural disasters can befall us, but there probably are one or two more that we could experience.

Turning to the national outlook, data since our last meeting have certainly led us to revise down significantly our forecast for real GNP in this quarter and the next. Like the Greenbook, we expect the economy to be roughly flat in the current quarter. For the first quarter of next year we do have a slight positive; but since the uncertainty is so high I certainly wouldn't argue strongly with the small decline incorporated in the Greenbook. In the quarters that follow we have growth rebounding to around 3 percent, with the major source of strength being spending for inventories and also some strength in the interest-sensitive sectors of the economy. It seems to us that the outlook for inflation is clearly encouraging. It certainly was good to see the lower PPI and CPI figures for November as well as the moderation in unit labor costs. Overall, we expect a reduction of inflation in 1992 compared with the average of this year.

CHAIRMAN GREENSPAN. Incidentally, is there anything that is being done on the infestation to suggest that it can be eliminated at some point?

MR. PARRY. They really don't have many ways of dealing with it. Apparently, the chemicals don't work very effectively, so what they're looking for are some natural predators. I think they have found some small [unintelligible] or something like that that is a natural predator. But the infestation is spreading; it has already gone into Arizona and is moving a little farther north in California, but it won't get too far north because of the cold. But the Imperial Valley, which has mainly truck types of crops--lettuce, tomatoes, strawberries, and things like that--really has been devastated. The white flies have wiped out over 70 percent of the honeydew crop, for example.

MR. BLACK. What kind of insect is that white fly?

MR. PARRY. I don't know. I'll get the technical description later.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, I'll admit to feeling a bit on the gloomy side. In a District context, the moderating pattern that has

been in evidence for quite some while is continuing. I don't think it's necessarily accelerating, but it certainly is continuing.

As I have so frequently commented, the automotive business of course has a very major impact on the District's activities and it is continuing to exert something of a negative influence. The order rate for dealers has been consistently underneath the manufacturing production level with the result that the production schedules are continually reduced. In the fourth quarter, production is going to come in substantially under what just a month or two ago was revised to the very lowest level possible. There was something of an increase in the order rate in the first week in December, but I am told that about half of that increase was the result of fleet sales, not higher retail demand. The first-quarter production rates are very uncertain at this point. Initially, they have been set at a level a little lower than the fourth-quarter level, but there is every expectation that as we get into the quarter they will be reduced further. But because the first quarter of 1991 was so very weak, in a comparative sense at least the production levels may exert a positive influence. The forecast sales levels for 1992 are about one million units higher than 1991, but much of the increase is in the second half. And, frankly, it seems more of a hope than a forecast of the reality.

All of this is backing up into the supplier group. Steel companies are experiencing cuts resulting from the auto manufacturers. The orders have been reduced by about 10 percent for January and February and, as a result, the operating rates in the steel industry have declined and are currently down to about 77 percent. Therefore, the first-quarter expectations for steel will be weaker than they were before. Still, they are expecting for the full year that shipments will come in at about 82 million tons. That would be up from about 78-1/2 million tons this year. The other suppliers to the auto sector are experiencing similar curtailments. It looks to us as if in a direct and indirect sense the automotive industry may have a negative impact of as much as 1 percent on fourth-quarter GDP; and it may also have a continuing negative effect in the first quarter.

The heavy truck business continues to be terribly weak. The class A truck shipments this year will come in at about 100,000 units. For next year the expectation is that the shipments will go up to 109,000 units, so it's quite an increase. Nevertheless, we have to compare that number with what shipments could be in a good year, and shipments could come in--have come in--at as much as 175,000 units.

District employment increased in October; that's the latest month that we have available. But the unemployment claims rose in November, and a survey of hiring plans for the first quarter indicates a decline in the Midwest from the fourth quarter. The Chicago Purchasing Managers survey indicated a pretty substantial decline in November; there was even a steeper decline in Detroit. And the Chicago December report, which will be coming out later this month, shows a further decline.

With regard to retail sales, it's a little hard to get a picture; but I think the outlook is a little better, particularly for those in the discounting business. For those people the early Christmas sales seem to be running a little over last year. But alternatively, those who are not in the discounting business are

having a very tough time. One specialty retailer I talked to said that currently he's having the worst experience he has had in 29 years. He gave me a report on sales in the various regions that they cover and I was surprised that in Chicago in the first week of December they had an 8-1/2 percent decline in sales from the first week of December last year.

On the inflation side, given the competitive conditions, pricing is really very, very tough. One major manufacturer said that they have gotten decreases in the prices of their outside purchases of 1.4 percent this year and they are forecasting a further 0.6 percent decrease next year. Despite some attempts to raise steel prices, I am told that steel prices more broadly are still at about the 1980 levels, so there is no improvement there. The wage patterns continue to be favorable, but I will say there's a growing level of anxiety about the Caterpillar strike, which at this point looks very, very difficult.

In a national context, the reduced staff forecast certainly seems plausible. In fact, our current look at the first quarter would be just a bit better than the staff forecast, but we have the remaining quarters of 1992 weaker than in the staff's outlook. I think there's a lot of hope in this expectation that we'll get a turnaround. To me the risk is that the growth rate, if we get it, won't be strong enough to sustain itself and that we could, therefore, get back into a deteriorating environment. And it seems to me that our policy actions have to deal with that risk.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, I think it's a very difficult time to forecast. Of course, it's always hard but it is particularly difficult now. Looking back, the vast majority of forecasts--and that certainly includes our forecast--underestimated the strength of the negative forces that are apparently working in the economy. But I guess by now we really should realize that some of this restructuring and downsizing that we've seen in a lot of different industries will not only eliminate existing jobs--forever probably--but will also raise a lot of doubts in the minds of others about their job security, with predictable effects on consumer and business confidence. I think we've all been aware that there are some important structural changes taking place in the economy, but we underestimated the extent to which they were restraining consumer income and spending. And, of course, in this highly uncertain environment, the disinflation process is making it increasingly difficult for businesses to pass on any increase in prices. The firms are naturally very reluctant to hire and are cautious about inventory management, not to mention capital expenditures. This caution really augurs well for the long run because I think we're going to emerge with a much more competitive society than we had before. But certainly in the short run it has some implications for the level of business activity and I think it's going to retard the recovery beyond what we had thought earlier.

When you think about the structural changes and couple those with some cyclical changes occurring on top of them, it makes it very difficult to predict how strong and how persistent these restraining forces are going to be and to what extent they're going to be offset by the lagged effects of the considerable easing in monetary policy

we've done over a period of a number of months. The Greenbook projections of the real economy strike us as reasonable and quite plausible, given what we now know. We do think the staff might be a little high in their projections of inflation, although those are certainly reasonable. But I believe the inflation outcome in [1992] is going to be a tad better than projected in the Greenbook if we can maintain the System's credibility about our long-term objectives. That last point is a very crucial one as we move into this policy-setting process today. Another measured step toward ease of the sort we've been taking for some time is probably appropriate now, but I think any more aggressive move would be quite counterproductive at this point.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. In the Philadelphia District, I'd say [activity] is flat to down, with little prospect for an upturn on the horizon. Manufacturing, which had been a relative bright spot earlier in the year, has turned down--and rather sharply--in December. Some of that is auto-related but it's broader than that. Construction, which had seen a modest improvement in housing, is down; there's a lot of gloom in the construction industry, with very little near-term prospect for improvement. Retail sales are about even with last year; but the number of people that the retailers are hiring is down, so there's a negative effect on employment. I still see a slippage in loan quality at banks. It's particularly evident--though it may just be because I've spent more time on it in the last few weeks--in de novo banks, which seem to be running into some additional problems. In terms of attitudes, I don't sense that there has been a deterioration in attitudes so much as a "hunkering down" kind of sentiment--a view that what we have may last a while.

Turning to the nation, the Greenbook forecast is certainly reasonable, but I think the risks are still on the down side, perhaps more so than six weeks ago when we last met. It's difficult to find a sector to lead a recovery. And having gone through this so-called inventory cycle, I have less confidence in that the second time around than the first. I think this hunkering down attitude just reflects less confidence that we will have a recovery. There's also a second downside risk and that is that monetary policy will continue to have less of a stimulative effect than one might ordinarily think. This could very well turn out to be one of those recessions--and we've had them before--in which we have to push the fed funds rate below the inflation rate in order to get the kind of forward momentum to the economy to bring the Greenbook forecast about. In any event, with inflationary pressures subsiding--and they clearly are--I think this double-downside risk provides room for some additional monetary easing, and I would prefer it sooner rather than later.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. Thank you, Mr. Chairman. As has been the case for some time now, District business activity is mediocre. It really hasn't weakened much--and we seem to have been insulated from some of the major problems around--but it isn't all that strong either. Unemployment remains uniformly low in the District; attitudes, nevertheless, are quite negative. There are some positive signs, for what it's worth. It really is true that you can't find a parking



space in the shopping malls on the weekends. Retailers are quick to point out that people are looking for bargains and not buying as much as they used to, and so forth. But we'll see if that plays out. All I can tell you is that there's a lot of traffic. The auto dealers report that sales are bad but traffic in the showrooms has picked up. Perhaps people are looking for bargains or perhaps they're getting ready to buy something sooner or later. In any event, there's at least a glimmer of hope there. Sectors that have been in pretty good shape for some time include tourism, agriculture, and the retailers who are reachable from Canada. Those areas of the economy continue to move along as they have been moving and really are quite healthy.

With regard to the national situation, I agree with the comments that have already been made and, as the Greenbook forecast is currently depicting, that the risks are probably symmetric. I was puzzling for a long time as to why attitudes, particularly business attitudes, are as bad as they are, given that the aggregate data don't look that bad. But it seems to me that the aggregate data are starting to catch up with the attitudes, and that's reconciling that difference at least in my mind. But what I would emphasize at this point is a comment that Mike Prell made earlier, which is that disinflation is in train. And I think that's something that we can look forward to. Anecdotally, it's very hard to find much in the way of price pressures. I was struck by a meeting we had at the Bank recently during which a lot of private-sector employers in the Twin Cities reported [that they expect] wage increases of about 3 percent for the year ahead. Of course, benefits are rising more rapidly than that, but 3 percent is the kind of number we haven't heard in the Twin Cities in quite some time. There's a lot of concern looking to the future about aggregate demand; but we've been looking at supply, recognizing that that's somewhat of an artificial distinction. But it looks to us at least as if the 1980s were characterized by unusually rapid growth in labor force participation and unusually large increases in hours worked. If that is not repeated in the 1990s, and it doesn't seem likely, then the supply side of the economy's ability to grow seems to me to be constrained unless we get real improvement in productivity--which, of course, is possible, but hard to bank on--or unless we believe that when the aggregate demand comes back the gaps are going to be made up by imports. So, we may be looking at a situation where not only is aggregate demand likely to be subdued, but the growth in productive capacity may be as well.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. Yes, Mr. Chairman. Even though it seems as if the economy is dead in the water--and the forecasts for the fourth quarter and the first quarter certainly suggest that--I think it's better to look at the economy as being balanced by certain sectors and regions in which growth is occurring, albeit rather slowly, and other sectors and regions in which there are continuing adjustments and some retrenchment. So, it seems to me that there still is not the synchronization of all of these sectors and regions into a common inventory cycle phenomenon. Consequently, it seems to me that the seeds for growth are building even while we're in this period of a pretty flat economy.

Secondly, I want to suggest that the pessimism we see associated with this [economy] is a real estate phenomenon. It's a

long-cycle real estate phenomenon and it is accompanied by depository institution difficulties that look just like those that were experienced in the 1920s and 1930s. And it seems to me that we are not immune from the sense of pessimism associated with that kind of an event. I think it would be well for us to remind ourselves of some significant differences between the current conditions and those that prevailed during that last banking-real estate episode.

First of all, I would suggest that the monetary aggregates--whether you look at M1, M2, or M3--are growing; they are not contracting. And there's a substantial difference between monetary contraction and slow money growth. If you look at M1 as well as M2, there's some indication here that we are supplying liquidity to the system. And that liquidity, as shown in the steep yield curve, will work its way. Now, in the 1930s the banking system did not have the heavy concentration of Treasuries in their portfolios that they hold now. At that time, as many of you probably remember, the government debt was contracted from about \$24 billion in 1920 to about \$16 billion in 1929. So, in that episode, we didn't have commercial banks chasing yield into long-term Treasury securities. And the commercial banks had a quality bond problem. It wasn't just a question then of having bad loans; it was also a question of having bonds, both municipal and business corporate bonds, that were not marketable. And when that quality spread developed, the banking system was, of course, locked in with those securities. So, they didn't just have bad loans. They had bad loans in bonds as well as bad loans of the usual kind. Of course, they did not have something that we have today and that is deposit insurance. I know a lot of people have been complaining about deposit insurance systems, but this is not too bad a time to have one, it seems to me! [Laughter] And, of course, that's why we haven't had a monetary contraction. If we had had these depository institution failures without deposit insurance, it seems to me that there would have been no way we could have kept the money stock growing.

The second thing I would mention is that we are not in a deflation period as measured by the producer price index. In the latter 1920s and early 1930s, we had very steeply declining prices that brought the price level down 40 to 50 percent below where it had been before. We haven't yet had what I would call a significant producer price index decline. And the fact that the PPI for finished goods is now year-over-year at minus .5 percent is hardly an indication of a deflation underway.

The third point I would mention is that our system is indeed a transfer payment system that does offer a huge amount of support. I mean by that not just Social Security, but Medicaid, Medicare, and unemployment compensation, and also a rather large pension plan program. So, that provides a great deal of sustenance.

The fourth thing I'd mention--I know one could add more to the list but I'm going to stop at four--is that world trade is expanding. It's not expanding quite as rapidly as it was a few years ago, but it's still expanding. And in the 1930s, as you know, we were undergoing the threat from the Hawley-Smoot tariff. So, this circumstance is so different that to me it doesn't make sense for us to let that kind of fear permeate our ranks.

Now, as to the monetary aggregates, I frankly am not worried at this point about M1's growth rate. When I look at M1 and M2--and M2 seems to be dawdling along at a little higher [growth] rate than it was before--it doesn't seem to me that this is a problem at this point on either side. I'm not going to join the forces of alarmists in regard to M1. But I do remember, Ed, that in 1986 when I was not too worried about M2 growing at a rate of 9-1/2 percent and some of you were saying that that was a problem, that it did turn out to be somewhat problematic. So, I don't know at what point in time liquidity in a sense catches hold and shows up. At this point, commodity prices do not show any force of over-liquification as M1's growth rate might indicate. That is, I don't see any upward bulge in commodity prices that says we're putting too much liquidity in the system. But neither do I see commodity prices forecasting a significant deflation. It does seem to me, though, that the commodity prices are forecasting stable producer prices and some diminution in the commodity price index. But I think it's worth noting Bob Parry's report regarding agriculture. Civilizations do go through periods in which certain [anomalies] in agriculture show up. And it seems to me that we do run the risk that we're in an era in which food prices may be subject to more [unfavorable] surprises than good surprises.

In conclusion, it seems to me that the healing forces and the recovery forces--with a little longer time lags than we're used to--are really underway. I don't want to try to do any better at forecasting [than the staff]; I don't have any quarrel with Mike's forecast at all. I don't think we've ever been to this place before, and I don't know for sure that that's the way it's going to work, but it does seem to me that this is a time for a little patience.

CHAIRMAN GREENSPAN. Bill Hendricks.

MR. HENDRICKS. Thank you, Mr. Chairman. We concur with the Board staff's view that growth of the economy has stalled, although we are not quite as bearish about retail sales in the fourth quarter as is indicated in the staff's estimates. Perhaps, like Gary Stern in Minneapolis, we view the outlook from the vantage point of a District that has outperformed the nation since last spring, although there are signals of softening in our area, too. Ohio unemployment rose slightly in November for the third consecutive month and the unemployment rate held steady at about 5.6 percent, which is low relative to the nation. Retail sales and manufacturing production also have been stronger than the national averages, at least through September. And construction contracts for both non-residential and residential homes have continued to grow faster than for the nation through October. Our concern, as Si Keehn also has indicated, is that scheduled cutbacks in auto production extending into the first quarter of '92 may be working through the auto supply industries in our District. Steel operations are under downward pressure. Our steel contacts note that delivery lead times have been shrinking in recent weeks; customers are no longer on a quota; and order books for flat rolled steel now have openings for late January delivery. Capital goods production is still mixed but apparently on a slowly rising trend. I would conclude by mentioning that, despite a pervasive mood of pessimism, even among business executives we see no widespread cutbacks of capital spending plans. Indeed, some producers plan increases in 1992 and they have not changed their plans, while a few

others are scaling down spending increases in view of the lower-than-expected sales and profits in recent months.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Thank you, Mr. Chairman. In the First District the economy remains poor, but we have some hope that it may [improve] to mixed. However, there is concern that the mood--you probably saw that story in the front page of the Sunday New York Times about depression in New England--certainly exceeds the reality in terms of sourness. I think this is something that has been spreading nationally recently, not just in New England. But even though there isn't a fit between the mood and the reality, this does have a psychological effect which feeds back on the economy, and it's obviously something that overhangs [unintelligible]. We think that we probably would not be that far from the bottom in New England if we were to have a national outcome somewhat like that in the Greenbook in that employment losses are stabilizing and there is some beginning of stabilization in the banking situation.

On the retail side, we talked to retailers over the last several days and they say that people are being extremely cautious. This is reflected in some interesting ways. One way, according to a major retailer, is that as there are successive sales, a lot of people are coming back and bringing items to the return window because something they bought at \$14 last week is advertised at \$9.95 this week. So there's more foot traffic in a way than there are sales, though we don't have any problem with parking spaces at this stage! I'll report what one retailer told us regarding sales: Sales, while bad, are not terrible in that there's an expectation that on a year-over-year basis many [retailers] may actually break even, though some national chains we've spoken to have indicated that they see a spreading of the situation in New England to the rest of the country. Part of that is because inventories have been kept so lean, and purposely so. And some retailers say that they are losing sales because inventories are so lean. But if the choice is to take a chance on one side or the other, they are not going to [take it on the side of] inventories.

The job market remains very soft. A personal anecdote on that is that we have something called a "sunrise shift" in our cash operation, with hours from 4 to 8 in the morning and no benefits. It has turned out to be very effective for us. We had three openings on that shift and when we advertised in the Boston Globe we had 1,000 applicants. The applicants actually had to come in and apply--there wasn't any sending in of resumes--so we know that people were serious about it. On the other side, we do see some change in the timing of projects by state and local governments with the notion that this is a good time both to finance and to get lower construction costs.

As far as the Greenbook goes, we find it realistic this time and possibly even slightly too pessimistic--in terms of what it forecasts for the economy per se, not the potential results. We do think that the unemployment rate for any given level of output could be slightly higher than the Greenbook forecast. But, looking at all of this, one starts to [question] what went wrong and why things are so much softer than they had been. There has been some reference, and I think appropriately so, to the restructuring phenomenon and the

effect of that on confidence and to these longer-term issues about which there may not be much that we can do. Another interesting question, and I don't know the answer, is whether any of the changes in the tax code and the composition of employment this time have diminished the effect of the automatic stabilizers in some ways--there must be some data on this--and whether the decline for any given change in economic activity and federal receipts has been a little less this time. There are arguments one can make to say that that was the case. Whatever it is, things aren't working as expected. And in an [environment] in which things aren't working as expected--even though, as I say, the Greenbook forecast is pretty realistic--what I'm concerned about is the risk or the impact of an error. And I think Mike mentioned that. We've been through this a number of times; we don't need a lot of discussion on the amount of fragility in the financial system or in expectations. But I do think one has to be quite concerned about the potential spreading of this level of inappropriate panic. Like many other people, I do see an improvement in inflation. I see it on the wage side and, with the number of medical providers that we have in our District, we've begun to see even the beginning of some steps being taken on benefits, which will have an effect in the longer run.

As far as policy goes, I know that we have this overhang regarding what may happen on the fiscal side. But from my own perspective, that argues for our doing what we think we can more promptly rather than less promptly before concerns become evident [unintelligible] have a little less uncertainty about what the range of options may be on the fiscal side. I'll finish by saying that if an action is taken, I think there is some value to maximizing the signal impact of any given amount of change because of what I personally feel are the psychological aspects of this. There's nothing we can do about the short run but the environment that we've been in I think does demonstrate the problems involved in an interest-rate targeting regime and what that implies in terms of discrete steps.

CHAIRMAN GREENSPAN. Governor Mullins.

MR. MULLINS. Well, I think the economy is dead in the water with no forward momentum or maybe drifting back a little but with no momentum there as well. I can't really quarrel with the Greenbook forecast for the fourth quarter or the first quarter. For the second quarter of next year the Greenbook has 2.6 percent real growth in GDP. We haven't had a quarter like that in over 3 years. If we get it, it could be perceived as a boom and might be disorienting to people! [Laughter] I think that second quarter is where it is difficult to see what is going to happen. The Greenbook puts an emphasis on the inventory cycle and on a rebound of consumer spending as the saving rate falls. Since I've been here I haven't been impressed with our ability to predict inventories, but the logic is there for the inventory side. The consumer rebound is difficult for me to see when I think of the environment next year where the media will have a couple more negative quarters to work with. We will have a political debate which will aspire to divisiveness and may achieve it. I think there is serious downside risk for a stalled economy. The most obvious one, and the one I would be most concerned about, is that if confidence continues to be a problem, with the prospects for the political debate and the media hype, these fears will lead consumers

to increase their saving rate. And since they are 60 or 70 percent of the economy, that could propel us downward pretty quickly.

There are many other downside risks for next year, not only the fiscal policy foolishness. Already perhaps the speculation about an investment tax credit could be sufficient to freeze capital spending plans for a while. And, of course, we have large banks on the precipice as well as maybe a couple of industrial companies as well. There are international events. So, I see a little more risk on the down side. And, of course, underlying all of this is the continuing pressure from this retrenchment process, the balance sheet adjustment process, which it seems to me in retrospect has been going on for three years. The recent third-quarter GNP number, which has now been wiped from all of our data, was revised to 2 percent. We thought it was going to be revised up. That 2 percent real growth in GNP was the best quarter since the first quarter of '89, and I think it was the first quarter of '89 that was biased upward by drought effects. So, the compound growth rate over these three years from the first quarter of '89 to the first quarter of '92 as projected is 1/4 percent annually; essentially, we've had three flat years. So, I think the contractive pressure of this retrenchment process is strong; it's durable and it's stubborn. I see no evidence that it's on the brink of exhaustion.

Can monetary policy help? I think it can and has. One wonders where the economy would be without the easing actions we've taken. I believe the easing we did last year helped lift the economy out of the more traditional recession--the traditional Gulf or oil-price-related recession--which was superimposed upon this longer-term adjustment. More recently, I believe the moves we've made since August have helped stabilize the housing recovery and also have arrested the free-fall in M2 growth and put it back into the lower end of the range. But it seems to me the important role for monetary policy in the current environment is in facilitating this adjustment process itself. Monetary policy has raised stock prices. It has produced the issuance of equities, which has helped in the de-leveraging. It has decreased bank funding costs, which allows banks to create this margin that will help in building their capital. The reductions in the prime rate have reduced the debt burden for firms and consumers because a lot of home equity loans are tied to the prime rate. And, of course, mortgage refinancing has also reduced homeowners' debt burdens. Even though much of the force of monetary policy has been absorbed in this balance sheet adjustment process, I don't view it as wasted energy. This is important work for monetary policy; it is necessary and indeed unavoidable work. There is no way monetary policy can short-circuit those adjustment processes, and we shouldn't try to rekindle the excesses. I view a role of monetary policy as advancing the day in which consumers, businesses, and banks can turn to future growth. So, even if we don't see it immediately giving rise to real spending, I think it is still having a beneficial effect.

Where are we in terms of monetary stance? I think there are some positives here. We have moved [down] 125 basis points on the fed funds rate since August; we have moved 75 basis points in the last six weeks. M2 growth is once again positive and has moved [up] into the lower end of the [Committee's long-run] range. The dollar is down. It's still not as low as it was last year at this time, but it is

lower than the Greenbook forecast. That is offset a bit by the softness in the foreign economies. The stock market, despite a few shudders, has held up; the market sees no double-dip. One might make some argument on that as well, but at least it's up there. The yield curve is still steep. People are betting real money that rates are going to be higher in the future, and the quality spreads in the debt market also have remained relatively narrow. The housing market appears to be holding up. Consumer confidence is very low, but it's still well above the lows of last October and still well above where it was in the 1982 recession. At least on the Michigan survey that is true; the Conference Board [index] is somewhat lower. I think the recent round of easing and where we stand now has been sufficient to keep the economy from turning down and to keep it from gathering momentum on the down side. But it has left the economy pretty much at a standstill against these forces of retrenchment and I see the downside risks overhanging next year's environment.

I think we need to be moving ahead; it would be useful to accelerate the balance sheet adjustment process and offset its impact. Moreover, I think it's now safe to say that reports of M2's death were highly exaggerated. It was only a flesh wound. We saw M2's weakness in the summer and now we see weakness in the real economy, even though other aggregates were giving more positive signals. We have seen M1 grow at a healthy rate, but we haven't seen that associated with healthy [economic] growth. I wonder--and maybe Don Kohn can answer this later--my general impression on M1 is that it is growing a bit more slowly than our models would expect, given the reduction in interest rates. This time around we have no exogenous shocks; we have no oil price increases or wars; we basically just have to recognize the force of this retrenchment. And in this environment my view is that we ought to look for consistent monthly growth of M2 in the upper half of the range. I also continue to think that with a prime rate of 7-1/2 percent, given outside analysts' forecasts of near-term inflation in the 3 to 3-1/2 percent range, real rates to final borrowers remain high at 4 percent over prime. The real prime rate doesn't look like easy money to me.

So, in conclusion, I still think we need an adjustment in policy to acknowledge and incorporate the downward pressure from this retrenchment process and help the economy move ahead. I don't view this as aggressive counter-cyclical policy but rather as an attempt to achieve a monetary stance that will both facilitate this adjustment process and have a little left over for growth. I don't see potential damage to the objective of reducing inflation. We don't have high M2 growth. We don't have high credit growth. If you take the federal government out, credit growth is quite anemic. And we don't yet have a federal funds rate below the expected inflation rate. In last summer's Greenbook, we were satisfied with the disinflation path implicit in 3 percent real growth. Now we have a few quarters of flat or negative growth and I can't see the risks in returning to the 3 percent path. If we don't move, I think we risk instability.

How do we make the adjustment in monetary stance? My feeling is that it may be time to reconsider the pattern of moving in an incremental approach and making the smallest moves possible. I'm concerned that this may dissipate the impact of our actions and not have the signalling effect. I'm also getting a bit concerned about the way the market is responding to the easing pattern rather than

perhaps to economic fundamentals. They think we ease on employment reports and before [Congressional] testimony. They're predicting policy easing rather than focusing on the fundamentals, it seems to me. And I wonder how much benefit there is to making another fully anticipated minimum size policy move. We had academic consultants in the other day and one of them said, in effect: "It's time to get this mule's attention." I doubt that another 1/4 percentage point tap on the mule's head is likely to do much. It may be time to figure out where we want to be and get there and make a stand. So, I still think we need an adjustment in policy, but in view of the lags I believe we should try to get the work done ahead of the uncertainties of next year. I would like to be in a position where we would have the expectation that we would not have any easing to do next year--to be essentially in a symmetric position. We do have to save some ammunition for emergencies, but I'd rather make the bulk of the adjustment in a deliberate manner than gradually dribble out 1/4 points with the perception that we have a lot more to go. I'd like for us to be in a confident position to say the Fed has done its part; M2 is growing; real rates are not high.

My guess is that there is not a unanimous consensus on this; indeed, I think we have done a lot lately. We might consider at this stage waiting a bit and doing nothing--waiting a few weeks to break the pattern of ease and to let the market think about economic fundamentals. We could wait until the data are more convincing and then in our own time, for our own reasons, implement a discrete, significant, adjustment. If the data don't convince us, we can stand pat or move another 1/4 point. I think a few weeks one way or the other will not make a lot of difference. I certainly would not oppose a move now because I think we ought to have a lower rate, but I might prefer waiting until we have something to communicate rather than simply to move another fully anticipated 1/4 point. In my view, we don't have much room left and we ought to make every move count. So, even though I think we should make a move, if there's not agreement, it might be useful to break the pattern of a slow slide and step back and wait to make a significant move when we feel comfortable with such a move. Obviously, I wouldn't vote against another small move, but on balance I would be comfortable waiting until we have the confidence to make a symbolically louder move.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. Well, Mr. Chairman, at the risk of sounding like a broken record, I will restate my conviction that what we have now is a crisis or paralysis of confidence. There is clearly [underway] a deliberate restructuring of balance sheets on the part of consumers, businesses, and banks to reduce debt and increase equity and liquidity. And given current attitudes, until that adjustment is much further along than it is now, I think we will not see a return to stronger [economic] growth patterns. Confidence is at best an ephemeral concept and basically it is a psychological phenomenon. Perhaps if we had a clinical psychologist on the Committee, it might help! In the meantime, I remain unconvinced that confidence will be shored up by a further easing in policy. While I recognize that the burden of high levels of debt is somewhat alleviated by a lower structure of interest rates, at the same time I do worry about the dollar and the risks related to a steeper slide in its value due to an even more significant interest rate differential. A flight to safety



may be the thing that is keeping the dollar as stable as it is, given chaotic conditions in the Soviet Union and eastern Europe. And yet I am persuaded that we have not seen the full effect of the easing that we have already accomplished, and I would like to wait before initiating any further ease.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. Thank you, Mr. Chairman. Our District growth continues to be slow and we see no real improvement in [prospect] in the near future. In agriculture, we expect declines in income of between 5 and 10 percent this year and we anticipate similar declines next year. Activity in the oil and gas areas of our District continues weak. Drilling operations activity as of November is down about 30 percent from the year before and there are no signs of any significant improvement there. Manufacturers, particularly the auto companies that are operating in our District, are now increasing their furlough periods. The General Motors plant is going to go out for four weeks starting I think this week or next week. In the construction area, our District has seen improvements. As I mentioned last time, it's partly because we've had such deflation; but we've seen good residential activity and some nonresidential activity in parts of our District.

As far as the national economy goes, our staff feels that its projections are generally in line with those in the Greenbook. We're not quite as pessimistic for this quarter or the next quarter, but we're certainly not as optimistic about the rest of 1992. For inflation, our forecast is very similar to the Greenbook forecast. We see no really strong inflationary pressures going forward.

As for the implications for policy, then, we think there is room for easing, although our preference is along the lines of what Governor Mullins said in that we think it's something we ought to be prepared to do down the road but would wait and choose our time. I think that would be perhaps a more effective way of going forward. Thank you.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. Well, as everybody has already said, this is a tough one. Clearly, attitudes are lousy. To pick up on Gary Stern's point that the statistics are catching up with the attitudes: Maybe the causation is precisely in that direction and we have a classic self-fulfilling prophecy. Another interesting thing that is surfacing now in a rather forceful way, which is attitudinal in one sense, is that even among informed observers there is this notion that monetary policy is pushing on a string. I just don't think that's right. Mike Prell touched on it a bit. But if you look at the behavior of the so-called interest-sensitive parts of spending versus the so-called non-interest-sensitive parts, at least to date, the anomaly is not in the interest-sensitive parts; it's in the non-interest sensitive parts. It's not that the interest-sensitive parts are booming, but the big difference is in the non-interest-sensitive parts which, of course, is consistent with the view that monetary policy is not pushing on a string. When you look at it a bit more carefully in the context of this confidence factor, where are the big differences? It seems to me that one can say, at the risk of a major

oversimplification, that the big differences lie in two areas. The first is government itself. We do have for good and necessary reasons a more restrictive fiscal policy stance at the federal level, given where the economy is, than we had in earlier episodes. But what I think really makes the difference is the combination of the federal level and the state and local level. Indeed, it seems to me that the state and local sector in many, many different ways--including the way it affects confidence--really is one of the major differences in the economy and the performance of the economy in recent quarters.

Now, the second big difference is the one that many have touched on and that is the debt overhang problem. The point that Governor Mullins made is an important one. In part, the workout of the debt overhang problem has been going on for two or three years, and I don't think we fully recognized it when it began to take hold. But it is one of the reasons why the economy as a whole has basically been limping along for three years. And whatever you think of it, it obviously still has multifaceted implications both now and for the immediate future in terms of financial institution problems, balance sheet rebuilding, corporate restructuring, and all the rest of it. But the cumulative effects of those things have a lot to do with this confidence factor that everyone's speaking of. But even after having said that, I am still perplexed on the one hand and worried on the other as to why these measures of confidence have dropped like a stone in the last couple of months. We can argue whether they are at 1982 levels or 1987 levels, but they do just seem to have cracked. Again, I think Mike's point is right. The economics profession doesn't tell us much at all about what to make of that. Certainly, it doesn't tell us much at all about how to build that into a forecast or anything like that. As a matter of fact, the track record of those [confidence surveys] is lousy. Nevertheless, we have this sharp downward break in confidence against the history of all these other events.

Well, I don't know what to make of that any more than anybody else does. But it does seem to me that at the very least it raises further questions about the near-term outlook for consumer spending. As I think I mentioned at the last Committee meeting, the retail inventory situation isn't great. Now, when we talk to individual store owners, they say their inventories are lean as the devil; and when we go into our local department store and look around, the shelves don't look overburdened. But what we forget is that there are a heck of a lot more stores out there. There has been a tremendous increase in the number of retail outlets as a part of this boom of the '80s. So, the information at the level of the individual store may not be telling the whole story.

Another concern, in the context of this confidence factor, is the other side of Dave Mullins's point about the stock market. The stock market, of course, has been doing terrifically. With all of these new offerings and stock prices holding up the numbers, it is actually one of the few things that probably are helping to maintain confidence. But we have to remember that, by many conventional measures of PE ratios and things like that, the stock market is at a pretty high level given any kind of reasonable guess as to what near-term profits at least are going to be. Now, of course, it may be that the stock market has really gotten smart and is looking through the near term to the longer-term implications of the restructurings and

other things that are going on, which could be a big plus [over time]. Nevertheless, it is another area of concern.

When I put all that together along with what everybody else has said, I can't take serious exception to the kind of forecast that Mike has in the Greenbook or that of my own staff in New York, which isn't all that different. But I think the band of uncertainty is pretty wide, if for no other reason than that this confidence factor, as John LaWare says, really is the wild card.

CHAIRMAN GREENSPAN. President McTeer.

MR. MCTEER. Mr. Chairman, there has been very little net change in the economy in Texas and in the Eleventh District since our last meeting. It remains essentially flat with perceptions somewhat worse than the numbers. A lot of those perceptions are not based on local developments but on the continued drumbeat of national announcements of closings and layoffs. This past week we got two local jolts to confidence: One of Dallas' two newspapers, which was 112 years old, closed; then just the other day [unintelligible]. The prime candidate is one that's in the Dallas area.

We've done a lot of surveying in the last few days on retail sales, trying to pin down what has been going on during this Christmas season. It's very hard to pin down, but on balance the conclusion is that retail sales have not been too bad in the context of diminished expectations. Most of the strength is in discount stores such as Wal-Mart, Kmart, and Target; their sales seem to be up about 8 to 10 percent over last year. The conventional department stores and the chain stores such as Penney's and Sears are not doing as well, although their sales are up from last year, nominally at least, about 5 percent. Penney's, which is headquartered in Dallas, says its store sales are up about 5.3 percent over last year, but they report very weak catalogue sales. And the reason they give is very interesting, I think; it's because when they print a catalogue they can't take account of price declines, so it becomes outdated and nobody uses it.

Let me give you a quick year-end report on Eleventh District banking, because I'm pleased to report that in 1991 for the first time in several years we have not led the nation in bank failures. We are going to conclude the year with only 33 bank failures; that compares to 105 last year and 144 the year before.

CHAIRMAN GREENSPAN. How many are left?

MR. MCTEER. I might say that someone mentioned the timing of these banks' charters: A third of those that failed in '91 were chartered in the '80s. The failing banks are getting much smaller. The 33 in '91 had \$1.4 billion [in assets] and the 105 in '90 accounted for \$6 billion, whereas the year before it was \$24 billion and it gets bigger as you go back. After four years of aggregate losses, 1990 was the first year of aggregate profitability for the District banks, and that has continued into this year. But Eleventh District bank lending has continued to decline on net, and the bankers say that's because loan demand just isn't there. Property values are beginning to stabilize after about six years of deflation. I mention that because property values and banking trends still appear to be moving in the other direction in many parts of the country, and I

guess the message from the Eleventh District is that that does not augur well for a quick recovery.

On policy, I would just say that whenever we decide to take the next step, I believe it's important that we do all that we think is going to be necessary in the foreseeable future. Someone mentioned a moment ago that discussions of the investment tax credit can freeze capital spending. By the same token, I think expectations of still lower interest rates in the future can cause a postponement of big ticket spending as well. So, when we do decide to ease interest rates further, I think we ought to ease enough so that the directive becomes symmetrical and the probability of going one way is the same as the probability of going the other way the next time a move is made. And I would just comment that I would not consider lowering short-term interest rates a little more to be a major easing move because of the long period of very slow growth in M2. I think our current de facto procedure of targeting the fed funds rate and our pattern of small frequent changes may have given us the impression that we were doing more than we actually were on fundamental monetary policy. So, I think there is room for a further reduction without derailing our long-run objective of price stability.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, it's helpful to me as I look at the economy to think in terms of two separate sets of factors working together to retard economic growth. One is a cyclical set and the other is a secular or structural set. And they march to entirely different drummers, I believe. The cyclical factors are the usual suspects that we find over and over again down through the years: inventories, and so forth. I think they probably would have been overcome by now--or maybe would never even have emerged--in the absence of the structural problems that we have. The latter are much more important and they are much stickier. And I think they are going to have to be allowed to play themselves through to correction in the interest of long-term growth and stability. I would mention the debt overhang and several things that interplay one with another: the real estate depression, the credit crunch in all of its different manifestations, and the very large fiscal deficit, which has several different kinds of perverse effects not the least of which right now is the inhibition it provides to any counter-cyclical fiscal activity. And then, of course, there is the restructuring and perhaps downsizing in the services sector. Those are pretty powerful and pretty important structural and secular trends that are going on. The policy dilemma, as I would identify it right now, would be to allow these structural problems to go ahead and correct. I think it would be a mistake for us to try to abort them to the extent that we could. Obviously, we want to cushion them, but I don't think we ought to try to abort them. We should allow them to run their course and, obviously, we all want to be careful that we don't lay a foundation for future inflation. On the other hand, to the extent possible, we certainly want to try to ensure against having economic activity fall into a black hole, which I think haunts the back of our minds at this point. And we also want to do what we can to [encourage] an acceptably strong recovery as soon as possible.

Three sets of things go together with those conflicting desires in the way of activity. One would be, obviously, the recent

weaknesses we've had in the economy; we've been over that and I don't need to mention that any further. I do think it's important to stress maybe a bit more than we have this morning the stimulus that is in the pipeline from earlier monetary policy moves. The staff informed me that as of yesterday we have approximately 3 percentage points at an annual rate of stimulus in place right now for 1992 spread out over the year almost equally from the first quarter through the fourth quarter; it recedes a little by the fourth quarter.

CHAIRMAN GREENSPAN. That's on GNP?

MR. KELLEY. Is it GNP or GDP, Mike?

MR. PRELL. It's the output that we're talking about.

MR. KELLEY. Right. At any rate, there is a lot [in the pipeline] that is going to come along. That could turn out to be either a salvation or, possibly even before it's all over, a problem. If we ease further, that obviously ups the stakes on both sides of that. Net, it seems to me that monetary policy has already done a great deal. We have eased every month this year from January through December with the exception of May, June, and July when there seemed to be a recovery underway and we stopped. We started again in August, in what I think was a very early recognition that things were not continuing to go well. There's a great deal that the economy has to do for itself in the area of these structural adjustments--things that I don't see as being very susceptible to a useful assist from monetary policy. It may be that we've done enough or very nearly enough in terms of monetary policy now. I think that policy stability is an important virtue in and of itself and that quick starts and stops in policy are undesirable. And we could be getting close to setting ourselves up for one of those cycles. So, my preference would be to wait and see here. Obviously, if it appears that the economy is continuing to slide, we'd have to take appropriate action at that time. I do have to grant, of course, that there is a good case for going ahead and easing. The economy has reached lower levels [of growth] than I think many of us would have anticipated--certainly lower than I anticipated. It's relatively low risk to proceed to ease a bit more and it might help some at the margin. So, I would not demur from an easing, though I would prefer to keep our powder dry for a time at least.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Well, as a novice governor, I found this to be a very, very interesting discussion. My knowledge is about the same as what was contained in the Greenbook. The issue I would like to reflect upon is simply what one does when confronted with the Greenbook's statistical [data]. I guess I've been not too long out of a classroom when I was temporarily domiciled in the First District.

MR. MULLINS. It's a crowded District!

MR. LINDSEY. I'd point out that we have three Virginians sitting here; my colleague was born in Richmond. What one would look at first is the probability of being wrong, and I have no reason to dispute the argument that the risks are equally weighted on the up side and the down side from the Greenbook forecast. But I'd point out

that those are economic probabilities only. One never knows when another Saddam Hussein might come along, when something might happen in Russia or the Russias, or when something might happen in other parts of the world. Those kinds of surprises, while we might wish they were symmetric, probably are not symmetric; they are asymmetric on the down side. The implication of that probability is not helpful for solving our problem. On the one hand, if the risks are on the down side, that might incline one to ease. On the other hand, if the risks are on the down side, one might want to keep one's powder dry in case those risks come true. So, on the probabilities side, I have no answer.

One has to look at what the penalties are for being wrong on either side. On the up side, if the economy turns out to be more robust than we thought, the staff forecast suggests that we're going to have decelerating inflation through '93 in any event. In fact, if one looks at the labor market data, the big surprise is not that unemployment is as high as it is but that the rate is as low as it is. An analysis that we were presented with yesterday suggests that, using the standard [econometric] model, we're not going to see unemployment peak at 7 percent but at closer to 8 percent. We're fortunate that that's not the case; but that suggests that there's probably more labor market slack than otherwise. So, if anything, I would say the upside risks are very, very low. I don't see the penalty for being wrong, if the economy is stronger, as being very [large] on the inflation side. I think the downside [penalty] is great. If one looks at what could happen--really, we should compare the September forecast with what we have now--the real downside risk is that we're wrong by two quarters, just as the staff forecast was wrong roughly by two quarters in September. That two-quarter error in the forecast of when the recovery would start is 1-1/2 million extra jobs; it's \$69 billion in lost output at an annual rate. And since that will continue for about 2-1/2 years, the cumulative effect of that is a large number even in Washington. Other downside risks include banking problems--we know that there are weak banks out there--and, as Dick Syron mentioned, fiscal policy. Whatever they do [on fiscal policy] is not likely to be helpful, and perhaps we should think about positioning ourselves to avoid the downside risks of extreme Congressional action as opposed to modest Congressional action. So, in conclusion, Mr. Chairman, I would say the probabilities may be equally weighted. I would stress the penalties of being wrong. They are very modest for stimulus; they're very great if we're too tight.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. Thank you. I must say that, speaking toward the end of this discussion, there's not much I can [add]. I would say that the discussion has been extremely helpful, and it does portray the very difficult balancing situation that we find ourselves in now. I wish that some of the positive signs coming out of St. Louis could have carried through a little further. The negative economic signs that are portrayed in the Greenbook have been confirmed. If you make a list of the negatives and of the positives, the negative list is longer than the positive list. Nevertheless, the restructuring that has been discussed around the table does lay a very good foundation. Once we get through bumping along the bottom, I think we will be poised to move up with stronger productivity, better efficiency in the

services sector, and so on. And I do think the monetary aggregates are showing signs of getting back on track.

So, we're in this balancing situation and, perhaps a bit like Larry Lindsey, I've been trying to weigh what the penalties are on the down side. I haven't been in Washington that long but I am becoming sensitive to the political pressures; there might be worse things coming from the Hill or downtown--however one words it. Nevertheless, I do come down on the side of accommodating this continued balance sheet restructuring. From my perspective, David Mullins described the monetary easing that has occurred very, very clearly. I think we do need some more easing. [I don't know] whether the timing is right now or whether we should wait for a bigger bang, so to speak, to get that maximum impact. I could be persuaded on that. Nevertheless, I do think some easing at this time to continue the accommodation of the [business] restructuring would be helpful. I'm afraid, unfortunately, that I agree with the Greenbook that the economy is still likely to be moving along the bottom for a while. So, some easing at this point would seem to be helpful, but we're likely to need even more later on. To the extent that we can do it earlier rather than later, I think we're better off because if we go into the spring and we start to see that black hole widen, we might start seeing more [unintelligible]. And about February is not a grand time to be seeing a panic situation. Thank you.

CHAIRMAN GREENSPAN. I'm informed that coffee is here.

[Coffee break]

MR. KOHN. [Statement--see Appendix.]

CHAIRMAN GREENSPAN. Thank you. Questions for Don?

MR. BLACK. Don, I have been one of those who thought that M2 was flashing wrong signals. I even went so far as to say in one of my more frivolous moments that it was as if I were experiencing colic like a baby who has lost his pacifier. But looking at it now, as Governor Mullins indicated earlier, it might not have been flashing all the wrong signals. What has happened has been along the lines of what you would have expected, taking it at face value.

MR. KOHN. I would interpret its signals as partly wrong and partly right in the following sense: I don't think we're getting the extent of the damping in nominal income one would have expected from the kind of money growth we've had, especially with interest rates coming down. That should have boosted money growth and it didn't. Essentially, we have had unchanged velocity for the year but one would have expected a very sharp decline in velocity. So, I think we've had some shift in the money demand function. That means that not all the weakness shows through. At the same time, the forces affecting money growth--the credit crunch type forces, to use the overarching phrase here--clearly also have been affecting income. So, while not all the weakness in money growth has shown through to income, it has been a bit of a leading indicator, and I think that was true in 1990 as well as in 1991 in terms of weakness in income. Now, we tended to discount it in 1990 because the war intervened; the weakness in money was followed by weakness in income but that was said to be because of the war. Maybe looking back, the weakness in money should have been

telling us something about an underlying process in the financial system that was showing through to income. I wouldn't put percentage point by percentage point M2 and income together; I don't think one could do that. But I do think M2 has had some [leading] properties.

MR. BLACK. I think that's a much better answer than the one I suggested earlier. You had warned us that there might not be [unintelligible].

CHAIRMAN GREENSPAN. Any other questions for Don? If not, let me start off where Bob Black left off. I, too, sense that there's more to what is going on in M2 and that its weakness is more relevant as it passes through to the economy than I would have been willing to believe six weeks or six months ago. I think it's still obvious that a very big chunk of the M2 weakness is essentially structural; but to the extent that it is in fact taking disintermediation out of the system, it doesn't matter that it's structural; it's working there. The only ways one can look at it as being non-relevant are either: (1) through the displacement in mutual funds, which we've discussed; or (2) that in many respects the sharp declines in small CDs in the thrifts, for example, are not materially impacting home mortgage lending largely as a consequence of the extraordinary degree of securitization that has evolved in that market. But having said all of that, we are still dealing with something that suggests that the normal relationships between M2 and the economy are at least in part holding, which also means algebraically that  $P^*$  is still alive and well. And if  $P^*$  is alive and well, there is a good chance that the Greenbook may be overestimating the level of inflation. And that, frankly, is my impression. I do think that we're looking at success in bringing the inflation rate down a lot faster than we had any reason to contemplate. When one considers that there has been an extraordinary rise in state and local indirect taxes--sales and other indirect taxes that have been embodied in the price level--I think we are getting a core inflation rate, ex-taxes, which probably is doing a good deal better than we might readily grasp.

The economy is dead [in the water]. It's not decelerating; we are not getting really major problems. It is true that industrial production is down in November and that, on the basis of the weekly data we are looking at, it probably is going to be down in December. We are clearly looking at some secondary inventory recession, which is not atypical of previous pauses in past economic recoveries. What is really extraordinary about this particular period is what Jerry mentioned: namely, that in the context of a period not really all that much different from a lot of pauses in the early stages of a recovery, we have had such a dramatic drop in consumer confidence that one would presume that something fundamental has really struck us. We are all puzzling about it and, as Jerry pointed out, no one really knows exactly what happened. But let me throw on the table a possible hypothesis based on an additional piece of evidence. A very interesting survey came out last week as a Wall Street Journal/NBC poll. It indicated that the average consumer or voter--depending on how you wish to look at it--perceived that the economy was terribly important but that what should be done was not tax cuts for themselves, or middle income income tax cuts, but tax cuts for business. Even the capital gains tax cut got the majority vote in that context. What clearly came through, as best I could see, is this really very profound fear of the long-term economic outlook. What has



happened, I suspect, is that while the economy was coming back from the recession, it led to a willingness on the part of the average consumer to say essentially that it's coming back and that's okay. But as soon as the balance sheet pressures put the wringer on this recovery, I think there was an abrupt reconfirmation of their concerns about whether the long term is really out there. They observed increasingly that they are living in houses that are nowhere near the quality of those that their parents lived in, even though their parents may not have had the education or any of a number of other [advantages] they have had. And they are worried about the future. They ask: Where is it all going? This situation creates a very profound fear.

I must say that I find the fact that the savings rate is as low as it is in this particular context, frankly, slightly surprising. I think there's a good chance that it may move up, which leads to a conclusion that is an odd one in the sense that the economy isn't all that far down. You can't account for the consumer psychology with the unemployment rate where it is. But far more importantly you cannot account for the psychology with the layoff rate. The layoff rate is basically not fundamentally different from what it was in other years in the '80s, not even during the recessions. And initial claims, adjusted for the [number] of those in the labor force, also are not showing anything really extreme. Therefore, something different is basically going on. It suggests that if this type of psychology eases, it won't be all that difficult for a modest recovery to resurface. And since it is not all that far from the top of a recovery, the economy can probably come back pretty much in line with the Greenbook forecast. But, as John LaWare points out, there is something really fundamental involved here, psychologically. And it's going to be difficult to break this general attitude easily, although I do think that the balance sheet problems are probably now starting to ease because the market itself is creating a very significant countervailing force. We now have record equity issuance, which is de-leveraging the system. We have a significant volume of public offerings of debt securities, a significant part of which are being used to fund short-term liabilities, and that is taking off some of the pressure. Lower interest rates, as Don mentioned, are having an important impact on reducing debt service burdens. The market's courier system is working. And unless it cracks open, it probably will proceed in that way and we will look back at this period a year from now and say that we were unduly concerned. Frankly, that's my best expectation. Indeed, I'm saying that I think the Greenbook forecast is probably right.

As a consequence, as far as policy is concerned, my reading in this context is that the majority of the Committee favors some further downward adjustment in the rate structure. If that is in fact what the Committee chooses to do, that suggests that the Board will have to determine how the discount rate should be structured to get the maximum effect of the easing, especially in the context of this psychology. What I would recommend for today is that we vote to go asymmetric toward ease with a very strong presumption that unless improvements in the economy become evident rather quickly or unless we get significant evidence of a pickup in M2 in the period immediately ahead, it would be expected that the Desk would be requested to move lower. So, I would recommend an asymmetric directive, which I would characterize as hard asymmetric; the balance of the evidence is going

to have to be that the economy is really showing surprising signs of strength [to preclude an easing move]. There is a possibility that things that have been extremely dull could become very buoyant very quickly; were that to happen, I think we would want to stand pat. But if that doesn't happen, the meaning of what I suggest is that we would move lower. Governor Mullins.

MR. MULLINS. I support your recommendation. I think it's the right approach in the current environment.

CHAIRMAN GREENSPAN. President Syron.

MR. SYRON. Mr. Chairman, I support your recommendation as I interpret it, but I might go a little further. Let me say why. If we were to get the Greenbook forecast, with the turn, it might be not all that uncomfortable. But I'm afraid that the risks are not symmetrical on the cost side. I really do think there's a chance we will get an outcome that would be highly undesirable. And then I ask: What can we do about it? I don't believe policy is totally impotent. I don't think a lot of people do, given what has been talked about here. And in that sense, I really do prefer maximizing the signal effect of what we're doing. The first paragraph in the Bluebook says that following the last meeting there was a "slight easing of monetary policy," which it interprets as being a 25 basis point cut in the funds rate and a 50 basis point cut in the discount rate. If that's slight, I have some question about whether that's what we should be doing in this period of time. We could always reverse [an easing move] if we were to get happy surprises. I agree with your basic view that the most likely outcome is the one that is [in the Greenbook]. What I'm concerned about is the risks that are on either side. So, for that reason, my own personal preference would be alternative A.

CHAIRMAN GREENSPAN. President Hoenig.

MR. HOENIG. I agree with your recommendation.

CHAIRMAN GREENSPAN. Vice Chairman.

VICE CHAIRMAN CORRIGAN. I support your position. I'd just make a point that sounds absolutely preposterous in this environment: Things could develop, even in 1992, where we could get surprised on the up side. That sounds ridiculous right now, but let's not forget about that possibility.

CHAIRMAN GREENSPAN. I might say parenthetically that I presume it would be the desire of this Committee to move with due dispatch should that consideration arise. That has been the [stated position] of this Committee previously. But it's important for us to be aware that it may be necessary to preserve what has been really an extraordinary success to date on inflation. I must say, looking back, that I think we've had some lucky things happen to us. One of them is that our policy has been able to rein in inflation at a much more rapid pace than we had contemplated earlier. And it would be a shame if we were to let that get away. President Forrestal.

MR. FORRESTAL. Mr. Chairman, I would support your recommendation. A point of clarification: I assume you're talking about a 1/4 point move?

CHAIRMAN GREENSPAN. Yes. Let me put it this way: If it turns out to be more than that, the implication is that other things are going on and it would be appropriate under those conditions to have a telephone conference.

MR. FORRESTAL. Well, as I said, I would support your recommendation. I find myself in a bit of an anomalous position, as someone who has been urging ease for over a year, to feel a little uncomfortable with this position now. But that is because I think we may have done enough at this point in time. We need to keep in mind that there are very substantial lags in monetary policy and that anything we do now is not going to affect the fourth quarter and is not going to affect the first quarter. As I look at the profile of the Greenbook forecast, I think it's not a bad outcome given no additional restraint. And since my forecast for inflation is a bit higher in the 1993 period, I'm just a little nervous about overdoing this and making the kinds of mistakes we've made before. On the other hand, the arguments for ease of the kind that you are describing certainly are reasonable. We may get a very substantial psychological benefit from moving. So, I would support the recommendation.

CHAIRMAN GREENSPAN. President Melzer.

MR. MELZER. Jerry, if you think what you said sounded preposterous, wait until you hear this! To say I'm not worried about the real side would be silly; I think one has to be. But at the same time, I have the feeling that there's a limit to what monetary policy can do on the real side and that whatever it can do is only temporary. The permanent effect of our actions is really only on inflation. And I'd have to say that policy has become very stimulative in the last six months. To gauge that, I look at reserves and I look at narrow money. I do that because those are things we really affect through our actions. And both of those are growing at double-digit rates. One can argue about what that means, Alan. But in terms of being surprised about what happened to inflation, one of the things that we look at is a three-year moving average of M1. When you came on, in 1987, that was over 11 percent; and in the next three years the three-year moving average of M1 came down to about 3-1/2 percent or a little less. To us that indicated that the thrust of policy was very much on a disinflationary course and we've seen that flow through. Now, what worries me is that, given the actions in the last six months, that trend growth rate has moved up a full percentage point. My guess is that if we did nothing further, it probably would move up another full percentage point in the first half of next year. And I worry about the long run. I'm not sure we've stepped into the trap yet, but I think we're getting very close to making the same mistake monetary policy typically makes at this point in the cycle in that we could be sowing the seeds of the next inflation. Now, I don't disagree [about the near term]. I think we're going to see very good inflation numbers in '92 and we're probably going to see very good numbers in '93. What we're doing right now isn't really going to affect those years in terms of prices. I think the effects are further out. It gets back to what Mike was saying before. I worry about setting up a stop-and-go policy and putting us in a position where several years down the road we're going to have to tighten dramatically. I think the only chance of bringing inflation down in a permanent sense is through stable policy applied over a long period of time. So, that's my longer-run concern.

In the shorter run, what I worry about is the risk in foreign exchange markets. I was struck by Gretchen's describing that earlier. We have a fiscal policy that's in pretty tough shape; we're going to be looking at deficits next year of 6 to 7 percent of GDP; and we're going to be hearing a lot of political discussion about other measures that might be taken on the fiscal side. We could continue to have a weak economy with that background music and we could find the dollar under extreme pressure. If at that time we are sitting here with a monetary policy that is way out of position--and I'm arguing that I think we're getting there fast--we could have a real problem next year. So, where I come out is that I would not be inclined to change policy now. Obviously, that's not going to fly; I understand that from our discussion, but that would be my preference. What I would argue for, assuming that we do make a change, is that we begin to communicate in some fashion that monetary policy has done about all it can because, if we don't start getting that message out there, expectations and pressures and so forth are going to continue to try to stampede us. David, you talked a bit about this. I probably wouldn't favor doing it with as aggressive a step as you would, but we need to get that message out. And we need to do that relatively soon or we're going to continue to get run over by these pressures.

CHAIRMAN GREENSPAN. President Black.

MR. BLACK. Mr. Chairman, I always feel very uncomfortable when I disagree with Tom Melzer, and I'm partly with him because I think we've done almost enough. But if we adopt your proposal of moving [the funds rate] 1/4 point--and I would add a gratuitous bit of advice to the Board of Governors that they couple that with a 1/2 point cut in the discount rate--I think, and hope, that the market probably would conclude on its own that we've gone as far as we are going to go. And some people will come out of the woodwork when they think rates have gone as low as they're going to go.

MR. KELLEY. That's right.

MR. BLACK. I would be a little more leery of taking that second step because I think a 1/2 point move on the funds rate, even if it's done later on, might look surprisingly close to these ridiculous suggestions we've been getting with regard to fiscal policy. I basically buy what you have suggested, but I share some of Tom's nervousness that we're almost there.

CHAIRMAN GREENSPAN. Mr. Hendricks.

MR. HENDRICKS. Yes, Mr. Chairman. We come out just a bit different from your recommendation, perhaps a little closer to Tom Melzer. We acknowledge the potential for a no-growth economy this quarter and next. But we don't believe further action by the Fed can do a whole lot to counter the near-term weakness in output. Neither do we believe that the Fed can or should do much to offset the structural imbalances in the economy that have been talked about around the table here today: real estate, the decline in defense expenditures, debt overloads, and so forth. Apparently, M2 growth has revived recently and might now be on an acceptable path that is close to the midpoint of the target range. We've cautioned against a policy oriented around a reaction to real-time economic data. History has shown, it seems to us, that such a policy process can mislead

policymakers into thinking they can fine-tune these economic activities. Moreover, it seems to us that such a policy process also leads policymakers to lose sight of the key long-term objective of maintaining price stability. So, our policy prescription, while not a whole lot different from your recommendation, is that the FOMC hold a steady course at least for now until we see the cumulative results of our several actions to cut interest rates over the past year.

CHAIRMAN GREENSPAN. Don is a little concerned that maybe what I said wasn't clear. I'm saying that my recommendation is to do nothing now but to have an asymmetric directive. I don't think that has been--

MR. ANGELL. Yes, Bob Black I think stated it a little differently, but that's the way I heard you.

MR. KELLEY. Yes.

MR. BLACK. I didn't hear it that way. I'm sorry.

CHAIRMAN GREENSPAN. Oh no, I'm sorry.

MR. LAWARE. You're saying "B" asymmetric?

CHAIRMAN GREENSPAN. "B" asymmetric.

MR. MULLINS. A hard asymmetric.

MR. BLACK. When you invoke the proviso, if you have to, you would go 1/4 point and that's all?

CHAIRMAN GREENSPAN. Yes. I'm sorry if there was any confusion. I'm recommending "B" asymmetric.

MR. BLACK. I guess I'm the only one who is confused!

CHAIRMAN GREENSPAN. No, apparently, [I wasn't clear]. I'm sorry about that.

MR. BLACK. No, it's my fault.

CHAIRMAN GREENSPAN. President Parry.

MR. PARRY. Mr. Chairman, I could accept "B" asymmetric. I would hope that [if and] when the rate is moved that it would be accompanied by a change in the discount rate and that we would find some opportunity to emphasize or highlight our longer-term objective. In addition, I'd emphasize the point that we've made around this table that it's important for us to be willing to reverse direction when circumstances dictate. And I would like very much to disagree with Tom Melzer, if I am understanding him correctly. I don't want to join this dialogue that monetary policy can't do any more. I think that's wrong. There may be an issue of whether we should do any more, and that's certainly a legitimate question. I hope we never join the group that says that we're pushing on a string and can't do any more.

MR. MELZER. I don't think I said that, Bob.

MR. PARRY. I think you said: "We can't do any more." Maybe I didn't hear what you said. What did you say?

MR. MELZER. That we shouldn't.

MR. PARRY. Oh, I thought you said we couldn't.

MR. KELLEY. Shouldn't, not can't.

CHAIRMAN GREENSPAN. Governor Kelley.

MR. KELLEY. Mr. Chairman, I support your recommendation but I do stand spiritually with Messrs. Melzer and Black.

CHAIRMAN GREENSPAN. President Stern.

MR. STERN. I, too, support your recommendation. The only thing I would add at this point is that, while it's certainly understandable that there's some frustration around the table in terms of the results we've achieved to date--at least in terms of the real economy and its tendency to fall below expectations--I think we should resist the temptation to try to do something more dramatic and more heroic. I believe the course we have been on has been the right one and I think we ought to continue with that. As many people have already commented, a lot of the problems we face are structural and are not amenable to changes in monetary policy. And I think, as you suggested, that we are not very far from where we want to be in any event. So, I'm comfortable with your recommendation.

CHAIRMAN GREENSPAN. President Boehne.

MR. BOEHNE. I would prefer alternative A. I think there still is a positive role that monetary policy can play both in terms of healing some of these structural wounds as well as providing some cyclical uplift. And given my reading of the downside risks and the cost of being wrong, I prefer to get on with it.

CHAIRMAN GREENSPAN. Governor Angell.

MR. ANGELL. Mr. Chairman, I can vote for your proposition, as I'm sure you anticipated that I would. Thanks a lot for giving me a chance not to have to write another dissenting statement! I do want to suggest that during the last six years I've become a bit less optimistic in regard to how easy it is to get the rate of inflation down. When I came in, I had the view that inflation could be brought down by gradual and persistent control of the money stock even if unemployment is at its natural rate. My experience is that it's very tough to get the CPI rate of inflation down. And I don't know why we're looking a gift horse in the mouth. Here we have had some unexpected occurrences, which means that the rate of inflation is going to come down a little faster than we thought it was going to. But we're committed not to let it turn into deflation. We're just not going to let that happen. I don't know, Mr. Chairman, whether there's more pain doing it this way than there is doing it over a 10-year period. I feel quite confident that this improvement in the outlook for inflation will make the recovery that we finally get a much better and a long sustained one. I do look forward to the discussions that I

think we might be having, particularly in regard to Governor Mullins's comments, and I guess I get to vote again. So, thank you.

CHAIRMAN GREENSPAN. Many times. President McTeer.

MR. MCTEER. Mr. Chairman, my view doesn't change the tally but I would have preferred alternative A. I think we all are very confused about the current stance of monetary policy, including me. If it's narrow money that's important, it's too easy. If it's short-term interest rates that are important, policy is not as easy as it seems; we have in this recession reduced the fed funds rate by a smaller percentage than in previous recessions. And if broad money is what is important, policy is too tight. This is the first recession in the last 30 years, I believe, where the rate of growth of M2 has not increased during the recession. If we believe M2 is the right M, we need to be more aggressive. I believe the next move ought to be a 1/2 point move because I think it's important that people stop perceiving that every time we do something we're going to do something else a week or two later. The next time we move the perception ought to be that we have done our thing and people should stop waiting for the next shoe to drop. People are out there trying to make decisions --they want to buy a house or a car--and as long as they think there's a little more [reduction in rates] to go they're going to be postponing those decisions. When we do make a move, if it's correct to do so, it's important that we emphasize the slow growth in M2 because I think that's the best way to set the stage for the time when we're going to have to reverse the course and [raise rates]. And I think M2 will be our most consistent explanation for changing course.

CHAIRMAN GREENSPAN. President Keehn.

MR. KEEHN. Mr. Chairman, given my concerns about the outlook and the overall situation, I'd be very much in favor of doing more and doing it now. I'd be in the Syron/Boehne camp, supporting alternative A. Having said that, as I hear your recommendation, the evidence of economic growth would have to be very, very compelling in order not to ease. If I'm right about my interpretation of that and if the move might be in the near term, then I support the recommendation. But if I'm not right, I don't know how you can be more precise about exactly what you mean in terms of the indicators that would cause you to do something. If I'm not right in my interpretation, then I'd be in favor of alternative A.

CHAIRMAN GREENSPAN. Governor LaWare.

MR. LAWARE. I would prefer "B" with symmetric language. I really think that we have to send a firm sign that the [downward interest rate] drift is going to stop. That could have a very stimulating effect because I think the economy and the public are being exposed to something akin to Chinese water torture. We creep down 1/4 point in the funds rate and then we creep down another 1/4 point and we change the discount rate. If we follow that same pattern, it seems to me that we are creating the expectation that that pattern is going to continue almost indefinitely. I think there's a lot to be said for turning it off, at least for a while, and seeing what happens. I'm still not convinced that all of the effects of our previous easings have come through and I don't see why we need to continue this drift. So, I would be in favor of "B" symmetrical.

CHAIRMAN GREENSPAN. Governor Lindsey.

MR. LINDSEY. Mr. Chairman, I'm happy to be able to support your proposal. I am struck, however, by comments from people who are disagreeing with your proposal on both sides. The term psychology is used by those who would not favor further easing and my good friend John LaWare has just made the case against further easing but by saying that water torture is going on. So, there is a great deal of sentiment at the table--and I'm struck by it--that we have not solved the psychological problem by this proposal. That issue may have to be revisited. But I am very happy to support your proposal, which I thought was a very well crafted statement of the [FOMC'S] position.

CHAIRMAN GREENSPAN. Governor Phillips.

MS. PHILLIPS. I also am pleased to support the proposal. I could have gone further, but I'm happy to support this proposal.

CHAIRMAN GREENSPAN. Tom, did I miss you?

MR. MELZER. You don't want to hear that one again, do you Alan? I'm "B" symmetric.

CHAIRMAN GREENSPAN. Okay.

VICE CHAIRMAN CORRIGAN. He thought he wrote you down on a piece of paper without [unintelligible].

CHAIRMAN GREENSPAN. No, I heard a long discussion but I didn't remember how you actually came out.

MR. MELZER. Well, I'm relieved.

CHAIRMAN GREENSPAN. Okay. As I read it, the proposal on the table will be "B" asymmetric toward ease with the new language that Governor Kelley drafted earlier. I'd like Norm to read it.

MR. BERNARD. "In the implementation of policy for the immediate future, the Committee seeks to maintain the existing degree of pressure on reserve positions." Then, the new language would be as on page 17 of the Bluebook--

MR. KEEHN. Norm, at the risk of interrupting, which I'm doing, could I ask the Chairman for just a bit more interpretation as to what you really mean in terms of the indicators that would cause you to do one thing or another? What would really make a difference in terms of monetary policy?

CHAIRMAN GREENSPAN. Essentially, what I have in mind is that if events do not change and if the quality of the outlook remains unaltered from where we sense it today, additional ease would be appropriate.

MR. KEEHN. Continuation of the current trends. Do you have a time perspective in mind?



CHAIRMAN GREENSPAN. Well, obviously we're dealing here with a time-frame encompassing the period immediately ahead; we can always have another meeting.

MR. KEEHN. Two to three weeks or something like that?

CHAIRMAN GREENSPAN. I don't want to be [too precise]. I couldn't disagree with you, but I'd hesitate to phrase it that concretely.

MR. KEEHN. Thank you.

MR. BERNARD. Continuing with the new language on page 17: "In the context of the Committee's long-run objectives for price stability and sustainable economic growth, and giving careful consideration to economic, financial, and monetary developments, slightly greater reserve restraint might or somewhat lesser reserve restraint would be acceptable in the intermeeting period." And then coming back to the standard sentence, as shown on page 15: "The contemplated reserve conditions are expected to be consistent with growth of M2 and M3 over the period from November through March at annual rates of about 3 and 1-1/2 percent, respectively."

CHAIRMAN GREENSPAN. Call the roll.

MR. BERNARD.

Chairman Greenspan	Yes
Vice Chairman Corrigan	Yes
Governor Angell	Yes
President Black	Yes
President Forrestal	Yes
President Keehn	Yes
Governor Kelley	Yes
Governor LaWare	No
Governor Lindsey	Yes
Governor Mullins	Yes
President Parry	Yes
Governor Phillips	Yes

CHAIRMAN GREENSPAN. Okay. Our next meeting is Tuesday and Wednesday, February 4th and 5th of next year.

END OF MEETING